UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
ENVIRONMENTAL FINANCIAL ADVISORY BOARD

Letter to EPA Administrator on Improving Small Business Access to Capital for Environmental Projects

July 8, 1997

Honorable Carol M. Browner
Administrator
United States Environmental Protection Agency
401 M Street, S.W.
Washington, D.C. 20460

Dear Administrator Browner:

The staff of the Agency's Common Sense Initiative consulted us recently concerning the access to capital enjoyed by three industries: printing, metal plating and manufacturing of circuit boards. Their concern was that these three industries were unable to borrow funds for environmental projects. In response to their queries and with their cooperation, we held an informal financial fact-finding session called a "charrette" with representative business owners from each of these sectors. We are especially grateful to Jack Greer and Beth Hickey of the Environmental Finance Center at the University of Maryland for their skillful help in organizing and facilitating the charrette.

On the basis of the information elicited during the charrette and other background material provided us, we find that while circuit board manufacturers enjoy adequate access to capital, the printing and metal plating industries do not.

The reasons for this lie in the structure of the two trades. Both are dominated by many small establishments which eke out modest profits from modest levels of sales. The average metal plating firm has sales of $1.1 million and after tax profit of about 4%. Furthermore, most firms are S corporations where retained earning are discouraged. They are often run by entrepreneurs whose total livelihoods are tied up in the business. In addition, although the assets of the printing industry generally enjoy a greater market value than those of the metal platers, few firms in either sector exhibit the balance sheet quality necessary to attract competitive lenders. Moreover, the physical assets of printing companies are needed to collateralize productive investments and are not available as collateral for environmental investments. In the metal plating industry, the physical assets generally have a nil value. Thus in neither industry can a realistic environmental loan program be grounded on the traditional banking concept of secured collateral. Indeed, we found that virtually the only viable asset of the vast majority of the companies in both of these industries is: the personal guaranty of the entrepreneur owner.

To encourage these businesses to make environmental investments, we recommend three courses of action which will result in a financially sound but highly flexible program to encourage environmental investment not only in these two industries but could also be expanded into other industrial sectors starved of environmental capital as well. They are:

1) The creation of an initially modest revolving loan fund of $5 million at the national level.

2) The solicitation of a suitable national public interest group, or groups, who would be willing both to put up $5 million of matching capital and to administer the program as well. The Agency's capital should be subordinated to that of the public interest group thus making it an extremely attractive investment.

3) A legislative proposal to amend the Small Business Investment Act of 1958 to permit the revolving loan fund to serve as the capital base for a Small Business Investment Company (SBIC) whose charter is to provide access to capital for environmental investments to smaller companies. This proposal would also modify certain current regulatory requirements of the program and extend the leveraging capability of this unique SBIC so that more industries and more companies could be served by this facility.

The concept here is to create a unique, flexible, but highly secure environmental loan program which will provide needed access to capital in an innovative format modeled on that of the Grameen Bank, a highly successful south Asian financial institution which has pioneered the use of micro credit and alternative collateral strategies.

In this regard, we recommend that the program emulate the successful micro credit and alternative collateral strategies utilized by the Grameen Bank in South Asia. Four key elements for such success are:

a) The personal guaranties of the owners.

b) The use of peer pressure to assure payment.

c) The elimination of physical collateral.

d) The reduction of all eligibility criteria to a few straightforward norms, established by a peer committee within the industry, with regard to the technological adequacy and appropriateness of the environmental investment.

In addition to the personal guaranties of the entrepreneur owners, the key to maintaining a sound fund will be a requirement that each loan applicant borrow an additional 10-15%. These overborrowings would be added to the capital base of the fund. (Although it might seem initially that such an overborrowing requirement would make the program less attractive, we must remember that the problem being solved here is an access problem, not a cost problem. This same situation is true in the case of the Grameen Bank which operates a highly popular program even though it charges extremely high rates.)

Once this new fund had loaned out its initial capital plus the additional 10-15% provided by the required overborrowings, it could then begin leveraging in accord with models developed for various State Revolving Funds (SRFs) under the Clean Water Act and the Safe Drinking Water Act. If the legislative proposal to permit the fund to serve as the capital base for an SBIC is successful, a much higher degree of leveraging can be achieved thus enabling more industry sectors to participate and more environmental investments to be made.

The above steps outline how the Agency can mount a new, unique and highly innovative program to provide access to capital for investments in environmental technology for certain industries which do not typically enjoy such access.

In order to create such a program, we recommend that the Agency initiate discussions at the highest levels with the appropriate officers of the Small Business Administration and with the appropriate representatives of the affected industry trade groups as well as public interest groups to begin drafting appropriate amendatory language to the SBIC statute to effectuate the program.

We also recommend that the Agency provide the initial seed capital for this fund and that it seek out a suitable public interest group to match the capital contribution and administer the program.

We are pleased to have been asked to advise on this matter and have enjoyed the opportunity to work with the Common Sense Initiative staff. We hope you will find our report of value in your continuing efforts to encourage environmental investment by private industry.

Respectfully submitted,

(signature)
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Chair
U.S. EPA Environmental Financial Advisory Board

(signature)
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